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Supreme Court, U.S.
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No. 95-1402

In the Supreme Court of the United States

OCTOBER TERM, 1995

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF OTIS C. HUBERT, DECEASED, C & S SOVERAN TRUST COMPANY (GEORGIA), N.A., A NATIONAL BANKING ASSOCIATION, CO-EXECUTOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

REPLY BRIEF FOR PETITIONER

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1. a. The court of apppeals expressly acknowledged that its holding in this case "brings us in conflict with the two other circuits which have decided the issue" (App., *infra*, 2a, citing *Burke* v. *United States*, 994 F.2d 1576 (Fed. Cir.), cert. denied, 114 S. Ct. 546 (1993), and *Estate of Street* v. *Commissioner*, 974 F.2d 723 (6th Cir. 1992)). Respondents do not assert that the decision in this case is distinguishable from the conflicting decision of the Sixth Circuit in *Estate of Street*. Respondents claim, however, that the decision of the Federal Circuit in *Burke* v. *United States* is distinguishable from the present case on the theory that the decision in *Burke* was compelled by state law rather than by federal law (Br. in Opp. 23-24).

The court in *Burke*, however, expressly refused to base its decision on state law, correctly stating that the "pertinent question" is one of federal law. *Burke* v. *United States*, 994 F.2d at 1580.[1] The court explained (*ibid.*; footnote omitted):

> While we do not find error in the Court of Federal Claims' determination that under Florida law the will required administrative expenses to be paid out of the principal of the estate, we believe that the emphasis on the source of payment allowable under state law shifts the focus of the case from the pertinent question—whether payment of administrative expenses must be accounted for in computing the value of a taxable estate under federal law for federal estate tax purposes regardless of the actual source of payment.

The court in *Burke* then proceeded to "examine the federal estate tax statutes" to decide the "pertinent question" of federal law. *Ibid.* Relying solely on federal law, the Federal Circuit reached a conclusion in *Burke* that the Eleventh Circuit has acknowledged is "in direct conflict" with the decision in the present case (Pet. App. 2a).

The decision in this case also conflicts with the decisions of the Fifth Circuit in *Alston* v. *United States*, 349 F.2d 87 (1965), *Ballantine* v. *Tomlinson*, 293 F.2d 311 (1961), and *Estate of Roney* v. *Commissioner*, 294 F.2d 774 (1961), aff'g per curiam 33 T.C. 801 (1960). Respondents mischaracterize these cases as creating only a "purported intra-circuit conflict" (Br. in Opp. 19). These decisions are binding on both the Fifth Circuit and the Eleventh Circuit (Pet. App. 21a-22a (Dubina, J., dissenting)). See Pet. 16 n.4. The contrary decision of the Eleventh Circuit in this case thus creates both an inter-circuit and an intra-circuit conflict.[2]

[1] See also *Burke* v. *United States*, 994 F.2d at 1581:

> [T]he deduction of administrative expenses as provided for by federal law—as opposed to the actual payment of administrative expenses as allowed under state law—must come from, i.e., be accounted for within, the gross estate.

b. The decisions in *Burke*, *Estate of Street*, *Ballantine*, *Alston* and *Estate of Roney* properly reject the untenable contention accepted by the court of

[2] Respondents err in contending that *Alston* v. *United States* and *Ballantine* v. *Tomlinson* turn on state law rather than on federal law. In *Alston*, the Fifth Circuit relied on the federal statutory scheme in holding that the marital deduction must be reduced by the amount of administration expenses. The court stated (349 F.2d at 89):

> No amount of legalistic legerdemain can produce * * * "the principle that where expenses of administration are paid out of post-mortem income, the amount of corpus available for charity is not diminished by such payments * * *" as argued by the executors.

In *Ballantine*, as in the present case, state law and the decedent's will permitted expenses to be paid from either corpus or income, and the executors chose to pay them from income. The court relied on federal law in holding that administration expenses that burden the marital bequest reduce the value of that bequest and therefore reduce the marital deduction (293 F.2d at 312-313):

> At the decedent's death his estate had the obligation of paying estate taxes, debts, charges and expenses of administration. * * * It follows then that the legacy to the decedent's spouse * * * was charged, at his death, with a like part of the expenses of administration, even though the amount of such expenses might not then be ascertainable.

appeals in this case that an estate may alter the estate tax consequences of its payment of administration expenses simply by altering its method of accounting for such payments—charging the expenses against the interest of the spouse in the "income" rather than the "corpus" of the estate. Administration expenses are an encumbrance on the gross estate that exists at the date of death, even though the amount of these expenses is not then ascertainable. When that encumbrance falls upon the portion of the estate that comprises the marital or charitable bequest—whether paid from the "income" or the "corpus" of the estate attributable to those bequests—it reduces the value of that portion of the estate and therefore reduces the marital or charitable deduction under Sections 2055 and 2056. 26 U.S.C. 2055, 2056. See Pet. 11 n.2 & 18-22.

Prior to the decision of the Eleventh Circuit in this case, the courts of appeals had consistently concluded that, when a marital bequest is burdened by the obligation of paying administration expenses, such payments reduce the value of the bequest and therefore reduce the amount of the marital deduction. Those courts had thus consistently concluded that the Commissioner's interpretation of these statutory provisions is correct. As Judge Beghe noted in his dissent in the Tax Court (Pet. App. 77a), academic and professional opinion also supports the Commissioner's position on this issue. See, *e.g.*, Brogan and Painter, *Administration Expenses May Lower Other Deductions*, 21 Estate Planning 131, 136, 137 (May/June 1994) (describing *Estate of Hubert* as an "astounding decision" that "contravenes the reasoning and holdings of the circuit courts that have endured over the years"); Irwin, *Tax Law: Administrative Expenses and the Charitable and Marital Deductions—The Potentially Painful Surprise of a 642(g) Election*—Estate of Hubert *v.* Commissioner, 20 U. Dayton L. Rev. 501 (1994).

2. Respondents contend here, as they did in the court of appeals, that a justiciable controversy does not exist in this case because "no decision by this Court can have any impact on the estate tax due [from the] estate" (Br. in Opp. 26). That inherently factual contention is illogical and lacks support in the record of this case. The Eleventh Circuit properly declined to address it.

Respondents' contention is purportedly premised on calculations they have made concerning the effect on the estate tax liability of the Commissioner's loss of a different legal issue, involving imputed interest earned on assets of the estate (Br. in Opp. 26; see Pet. 12 n.3). What respondents have overlooked in making these new calculations, however, is that the Commissioner's loss on that different issue was taken into account in the computations (under Tax Court Rule 155) that formed the basis for the Tax Court's decision that the estate had overpaid its estate taxes by $344,428.

The Commissioner has performed a tentative recalculation of the estate tax liability in this case based on the assumption that the marital and charitable deductions are to be reduced by the administration expenses that had been deducted on the estate's income tax returns for the period prior to September 26, 1991 ($1,656,859). That recalculation was submitted to the court of appeals and is attached as an appendix to this brief (App., *infra*, 1a-3a). This recalculation reveals that, if the Commissioner's position in this case were sustained, (i) the overpay-

ment of $344,428 determined by the Tax Court would be eliminated and (ii) the estate would be liable for an estate tax deficiency of $154,535.06. See App., *infra*, 1a-3a.

The Commissioner's tentative recalculation of the taxes owed by the estate is understated, for it takes into account only those administration expenses that had been incurred by September 1991. Five additional years have now elapsed, and the estate has incurred additional administration expenses that would further reduce the marital and charitable deductions and correspondingly increase the estate tax deficiency. There is thus a live and growing controversy in this case.[3]

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[3] Respondents' view that there is no justiciable controversy is premised, in part, on a comparison of the date-of-death residuary corpus ($26,224,436) with the sum of the marital deduction ($14,744,138) and the charitable deduction ($14,938,386) as adjusted by respondents' calculations of the effect of the implicit interest discount (Br. in Opp. 14, 26). Since the sum of the deductions (as calculated by respondents) exceeds the date-of-death residuary corpus, respondents contend that no taxes would be owed. But the estate tax is imposed on the *gross estate* less authorized deductions; the residuary value of the estate is not relevant in making that calculation. When the marital and charitable deductions are reduced by the the administration expenses incurred by the estate and paid from those interests (through September 1991), the estate has a net taxable value and an estate tax deficiency in excess of $150,000 (App., *infra*, 1a). The taxes owed would be even greater if additional administration expenses have been incurred and charged against the marital and charitable bequests since 1991. Under the decision of the court of appeals, however, a refund of more than $300,000 in taxes is required. Because the correct disposition of the question presented in this case will affect the estate's tax liability, the controversy is justiciable, not hypothetical or moot.

3. Respondents suggest that, by stipulating to the date of death value of Mr. Hubert's estate, the Commissioner has implicitly stipulated to the legal conclusion that administration expenses that are burdens on the marital interest in the estate do not reduce the marital deduction (Br. in Opp. 26-27). That contention is frivolous.

Neither the courts below, nor the parties, have had any doubt that the question presented in this case is a dispute about an issue of law—whether the marital and charitable deductions allowed by Sections 2055 and 2056 of the Internal Revenue Code are to be reduced by the expenses of administration of the estate that burdens those interests. It is that question of law that the court of appeals resolved adversely to the government and, in doing so, created a conflict among the circuits that warrants resolution by this Court.

As we have noted (Pet. 22-23), the question presented in this case commonly arises and is frequently litigated. Because the proper application of these estate tax provisions is an issue that must be confronted by any estate that contains a bequest to a spouse which—as is ordinarily the case—is burdened by the obligation to pay administration expenses, the question presented in this case arises for countless taxpayers. Resolution of this recurring question by this Court is needed to avoid continuing uncertainty and to assure even-handed application of the revenue laws.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

APRIL 1996

Dept of the Treasury - Internal Revenue Service — ADDENDUM

NAME: Estate of Otis C. Hubert
SSN: 252-05-1011
DATE OF DEATH: 02-Jun-86

GROSS ESTATE-PER RETURN	30,263,421.00	
ADJUSTMENTS-PER ATTACHMENT #1	0.00	
GROSS ESTATE-AS CORRECTED		30,263,421.00
FIXED DEDUCTIONS-PER RETURN	2,773,203.00	
ADJUSTMENTS-PER ATTACHMENT #1	25,139,410.00	
FIXED DEDUCTIONS-AS CORRECTED		27,912,613.00
INTEREST DED - PER ATTACHMENT #1		0.00
MARITAL DED - PER ATTACHMENT #2		220,747.00
CHARITABLE DED - PER ATTACHMENT #2		200,000.00
TAXABLE ESTATE-AS CORRECTED		1,930,061.00
ADJUSTED TAXABLE GIFTS		0.00
TAXABLE ESTATE PLUS ADJUSTED TAXABLE GIFTS		1,930,061.00
GROSS ESTATE TAX		749,327.45
LESS: AGGREGATE GIFT TAX		0.00
UNIFIED CREDIT		155,800.00
NET		593,527.45
LESS: ST DEATH TAX CR		2,957.00
GIFT TAX CR		0.00
FOREIGN TAX CR		0.00
CR FOR TAX ON PRIOR TRANS		0.00
TOTAL TAX LIABILITY		590,570.45
TAX-PER RETURN OR AS PREVIOUSLY ADJUSTED		344,428.00
GROSS DEFICIENCY (OVERASSESSMENT)		246,142.45
LESS: ADD'L ST DEATH TAX CR - IF SUBSTANTIATED		91,607.39
NET DEFICIENCY (OVERASSESSMENT)		154,535.06

Dept of the Treasury - Internal Revenue Service

Estate of Otis C. Hubert — ATTACHMENT #1

ADJUSTMENTS TO GROSS ESTATE

# 1	_____	0.00
# 2	_____	0.00
# 3	_____	0.00
# 4	_____	0.00
# 5	_____	0.00
# 6	_____	0.00
# 7	_____	0.00
# 8	_____	0.00
# 9	_____	0.00
# 10	_____	0.00
# 11	_____	0.00
# 12	_____	0.00
TOTAL ADJUSTMENTS		0.00

ADJUSTMENTS TO FIXED DEDUCTIONS

# 1	_____	12,525,143.00
# 2	_____	12,042,434.00
# 3	_____	200,000.00
# 4	_____	371,833.00
# 5	_____	0.00
# 6	_____	0.00
# 7	_____	0.00
# 8	_____	0.00
# 9	_____	0.00
# 10	_____	0.00
# 11	_____	0.00
# 12	_____	0.00
TOTAL ADJUSTMENTS		25,139,410.00

Dept of the Treasury - Internal Revenue Service

Estate of Otis C. Hubert — ATTACHMENT #2

COMPUTATION OF RESIDUE

CORRECTED GROSS ESTATE		30,263,421.00
LESS: CORRECTED FIXED DEDUCTIONS		27,912,613.00
INTEREST DEDUCTION		0.00
FIXED MARITAL DEDUCTION		220,747.00
FIXED CHARITABLE DEDUCTION		200,000.00
FEDERAL ESTATE TAX TIMES	0.00000000%	0.00
STATE DEATH TAX PD TIMES	0.00000000%	0.00
OTHER RESIDUE REDUCTIONS		4,808,000.00
CORRECTED RESIDUE AMOUNT		0.00